

## **NEBRASKA INVESTMENT COUNCIL POLICY FOR POLITICAL SUBDIVISIONS**

Statute 72-1259 states: “The state investment officer may provide assistance and furnish advice regarding the investment of money to any political subdivision of the State of Nebraska whenever such advice is requested by a political subdivision. In connection with rendering such service, the state investment officer may charge and collect any fee he determines to be reasonable.”

This document sets forth the policy established by the Nebraska Investment Council (the Council) in response and strict adherence to this statute.

The State of Nebraska Constitution explicitly prohibits subscription to stock by political subdivisions in Article XI. The statutes of the Legislature and significant precedent from State court decisions provide a distinction between the retirement funds of a political subdivision and the non-retirement funds of a political subdivision. The activity of the Legislature and the court system leads to the situation that the retirement funds of political subdivisions can own stock and the non-retirement funds of political subdivisions cannot. Thus, this policy distinguishes between retirement funds and non-retirement funds. Section I – Retirement Funds of this document is intended to provide guidance for the investment of retirement funds of political subdivisions. The non-retirement funds of political subdivisions which can not own stock are discussed in Section II – Non-Retirement Funds. The Prudent Expert Rule is applicable to all funds.

### **PRUDENT EXPERT RULE**

Statute 72-1246 states: “The state investment officer shall invest in investments of the nature which individuals of prudence, discretion, and intelligence acquire or retain in dealing with the property of another, and if the state investment officer has special skills or is named on the basis of representations of special skills or expertise, he or she is under a duty to use such skills, subject to the direction of the Nebraska Investment Council.”

Political subdivisions should use the same prudent expert standard in dealing with their own investments. They should establish policies and oversight processes to ensure that their assets are prudently invested by competent people.

In managing the portfolios entrusted to it, the Council establishes a hierarchy of investment objectives, strategies, and guidelines. The Council uses a formal process for selecting individuals or firms to manage the investments. The Council monitors the performance of all portfolios. Taken as a whole, this constitutes an investment management process intended to ensure the assets are prudently invested. The specific strategies, guidelines, etc. used by the Council are specific to the portfolios the Council manages. Even the Council’s investment process taken as a whole may or may not be appropriate for a political subdivision, since the nature of the Council’s portfolios is likely to be significantly different. The descriptions included in this policy are only to be used as an example.

## **SECTION I - RETIREMENT FUNDS**

### **INVESTMENT OBJECTIVES**

The Council establishes investment objectives for the assets of each fund it manages. These objectives reflect the purposes for which each fund was established. Each set of objectives usually contains a tradeoff between risk and return in the investment portfolio. This tradeoff is based on the Council's judgment of the ability of each fund to absorb potential losses and of the benefit each fund may receive from a more aggressive investment strategy.

For example, the Council manages the retirement funds for the School Retirement System of the State of Nebraska, Nebraska State Patrol Retirement System and the Nebraska Judges' Retirement System (the Defined Benefit Plans). The primary investment objectives for the Defined Benefit Plans are to maximize return on assets, minimize asset risk, maximize funding ratio return and minimize funding ratio risk. These objectives reflect the necessity of covering the liabilities of the Plans while minimizing volatility.

### **INVESTMENT STRATEGIES AND POLICIES**

For each set of investment objectives, the Council chooses an investment strategy that is designed to best meet the objectives. Typically there will be a number of strategies that do a good job satisfying the objectives. Therefore when choosing among strategies, the Council must consider all the implications of the strategy, not just the investment objectives.

For example, the overall investment strategy for the Defined Benefit Plans is 30% of the assets invested in fixed income, 50% in domestic equities, 15% in international equities and 5% in real estate. The funds are further diversified within these major asset classes by growth and value, large cap and small cap, etc.

### **INVESTMENT GUIDELINES**

Typically the assets of each fund are divided into several portfolios. The portfolios are designed so that, in aggregate, they implement the strategy for the fund. The investment manager for each portfolio is given a set of investment guidelines that must be followed. The guidelines constrain the portfolio sufficiently to ensure that the aggregate portfolio reflects the overall strategy.

For example, the fixed income portfolios used in the Defined Benefit Plans consist of four portfolios placed with different external portfolio managers. Each portfolio operates under specific guidelines that specify the credit quality of individual investments, sector limits, and duration restrictions.

### **MANAGER SELECTION**

The Council selects investment managers whom the Council believes will provide superior investment results consistent with portfolio guidelines. Typically the Council selects managers through a process which begins by issuing a Request For Proposal and ends with presentations by a short list of managers to the Council. The Council uses five primary criteria in evaluating managers:

1. Investment process
2. Organizational structure and stability / Quality of personnel
3. Resources available
4. Fees
5. Historical performance

### **PERFORMANCE MONITORING**

Performance benchmarks are established for each portfolio. Each portfolio and investment manager is monitored for changes in any of the five selection criteria. Changes that the Council believes may lead to future under-performance result in the manager's being placed on its watch list or terminated.

## **SECTION II - NON-RETIREMENT FUNDS**

### **INVESTMENT OBJECTIVES**

The Council establishes investment objectives for the assets of each fund it manages. These objectives reflect the purposes for which each fund was established. Each set of objectives usually contains a tradeoff between risk and return in the investment portfolio. This tradeoff is based on the Council's judgment of the ability of each fund to absorb potential losses and of the benefit each fund may receive from a more aggressive investment strategy.

For example, the Council manages a portfolio that contains the State's General Fund and the operating cash of most State agencies. The primary investment objectives for this Operating Investment Pool are safety of principal and liquidity, while return on investment is a secondary objective. These objectives reflect the purpose of these funds.

### **INVESTMENT STRATEGIES AND POLICIES**

For each set of investment objectives, the Council chooses an investment strategy that is designed to best meet the objectives. Typically there will be a number of strategies that do a good job satisfying the objectives. Therefore when choosing among strategies, the Council must consider all the implications of the strategy, not just the investment objectives.

For example, the Operating Investment Pool is to be managed primarily as a buy and hold ladder portfolio of high quality investment grade fixed income securities that also provide the necessary liquidity.

### **INVESTMENT GUIDELINES**

Typically the assets of each fund are divided into several portfolios. The portfolios are designed so, in aggregate, they implement the strategy for the fund. The investment manager for each portfolio is given a set of investment guidelines that must be followed. The guidelines constrain the portfolio sufficiently to ensure that the aggregate portfolio reflects the overall strategy.

For example, the Investment Policy Statement for the Operating Investment Pool defines the investment constraints by listing allowable investments and by setting allowable credit quality. It also places limits on the maturity of individual securities and shows sector diversification maximums and minimums.

### **MANAGER SELECTION**

The Council currently utilizes internal management to manage the Operating Investment Pool. Should that change, the Council would select an investment manager(s) through a quantitative and qualitative process that ends with presentations by potential managers to the Council. The Council uses five criteria in evaluating managers:

1. Investment process
2. Organizational structure and stability / Quality of personnel
3. Resources available
4. Fees
5. Historical performance

### **PERFORMANCE MONITORING**

Performance benchmarks are established for each portfolio. Each portfolio and investment manager is monitored for changes in any of the five selection criteria. Changes that the Council believes may lead to future under-performance result in the manager's being placed on its watch list or terminated.

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